Congress of the United States
Washington, DC 20515

October 18, 2005

The Honorable David M. Walker
Comptroller General
U.S. Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Mr Walker:

We are writing to request that you study the impact of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA)[1], on individual debtors, small businesses, administrative and consumer costs of bankruptcy, abusive credit practices, and credit card rates. Most of the provisions of this new legislation will take effect on October 17, 2005.

BAPCPA institutes a number of major changes to Bankruptcy Code that will place new restrictions on the ability of individual debtors to seek certain types of relief and obtain a 'fresh start.' Similarly, the new law places greater limits on the ability of small businesses to reorganize under chapter 11 of the Code.

One of the most far reaching changes would apply a means test to determine eligibility of individual debtors to obtain relief under chapter 7, by purporting to calculate the debtor's ability to repay non-priority unsecured debts over a five year period. Debtors who fail the means test will be presumed to be abusing chapter 7, and be required to seek relief under chapter 13. New paperwork burdens, limitations on the discharge, the restructuring of chapter 13, and new rights for creditors to bring motions against individual debtors, are expected to limit individual debtors' access to bankruptcy relief in either chapter.

The recent effects of Hurricane Katrina and Hurricane Rita on the Gulf Coast region have underscored the unintended consequences these changes to the bankruptcy system may have on families seeking relief from massive and unexpected financial obligations. Bankruptcy practitioners, academics, organized labor, and consumer groups[2] have expressed concerns that the new paperwork requirements, inflexible means test, and the small business filing requirements will prevent families and businesses facing catastrophic financial circumstances from effectively obtaining relief and a fresh start.

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[1]Pub. L. No. 109-8, 119 Stat. 23 (2005).

[2] Letter to Louisiana Congressional Delegation from Louisiana Bar Associations; October 6, 2005. *See also;* Letter from AFL-CIO, AFSCME, Center for Responsible Lending, Consumer Action, Consumer Union, et al. to Representatives of the U.S. House; Sept 26, 2005.

Opponents of BAPCPA have argued since the 105th Congress that the legislation will have an unfair effect on various classes of debtors who turn to the system as a financial safety net of last resort. A wide range of public interest groups including bankruptcy judges, lawyers, academics, organizations concerned with the rights of consumers, the needs of single parents and children, the elderly, working families, and civil rights[3] have all attested that the implementation of BAPCPA will have far reaching consequences. Moreover, the touted benefits of the new law – that it would target only genuine abuse of the system, and reduce the cost of credit for consumers – appear to many of us to have been exaggerated if not completely unfounded.

We believe that the integrity of the bankruptcy system must be safeguarded, and should provide "the honest but unfortunate debtor who surrenders for distribution the property which he owns at the time of bankruptcy, a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt."[4] As the Supreme Court has noted, "[t]he purpose of the act has been again and again emphasized by the courts as being of public as well as private interest."[5] Nonetheless, over the nearly 8 years during which Congress considered BAPCPA, there was broad disagreement as to whether the legislation actually accomplished these important public interests.

As a result of these concerns, we ask that you conduct a study concerning the following matters. Unless otherwise indicated, we would like the study to reflect the twelve month time period following October 17, 2005. We would like to receive interim status reports throughout your review.

1. Impact on Victims of Natural Disaster

As an initial matter, we are concerned that the hundreds of thousands of families and small businesses financially devastated by the recent effects of Hurricanes Katrina and Rita will be penalized by inflexible provisions of BAPCPA. As reported by the *LA Times*, "after virtually every major hurricane of the last 25 years, bankruptcy filings have grown significantly faster than

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[3] Letter from Martin Eakes, CEO, Self-Help Credit Union; Jim Blaine, State Employees' Credit Union, North Carolina; Terry D. Simonette, President & CEO, NCB Development Corporation; Calvin Holmes, Executive Director, Chicago Communit6y Loan Fund; Elsie Meeks, Executive Direct, First Nations Oweesta Corporation; Ceyl Prinster, Executive Director, Colorado Enterprise Fund; Bill Edwards, Executive Director, Association of Enterprise Organizations; Mark Pinsky, National Community Capital Association; John Herrera, Board Chair, Latino Community Credit Union; Fran Grossman, Executive Vice President, ShoreBank Corporation; Kerwin Tesdell, CEO, Community Development Venture Capital Associationto Hon. Dennis Hastert, Speaker and Hon. Nancy Pelosi, Minority Leader, U.S. House of Representatives (Mar. 14, 2005)(citations omitted)(on file with minority staff).

[4] LOCAL LOAN V. HUNT, 292 U.S. 234, 244 (1934).

[5] *Id.*

usual."[6] In many of these cases, filing for bankruptcy has been the only way for hurricane victims to cancel old debts in order to rebuild their lives, but under the new bankruptcy law many victims of Hurricane Katrina and future natural disasters may be denied full and effective relief.

A recent report by the Congressional Research Service (CRS) noted that the goals of the new bankruptcy law "may be at odds with the goals of those who want to assist Katrina victims through a speedy financial rehabilitation procedure under chapter 7 of the U.S. Bankruptcy Code"[7]. CRS specifies that some provisions of the bill may pose challenges to survivors' financial recovery, including the heightened level of burden of proof for prospective debtors, new limitations on debt forgiveness; mandatory record requirements, inflexible calculation of future income, and pre- bankruptcy credit counseling.

We have several particular concerns. First, we are concerned that individuals who are victims of natural disasters, and who incurred a substantial portion of their debt as a result of that disaster, will be subject to the "means test" and therefore be forced into burdensome repayment plans. Although the current law includes a narrow exceptions to the means test if the debtor can demonstrate "special circumstances," qualifying for such an exemption will be quite costly and burdensome, and require numerous detailed filings and legal certifications. Since the new bankruptcy law considers all income earned in the six months prior to the bankruptcy in applying the means test, this means that hurricane victims who have lost their jobs may be considered high income debtors who are presumed to be abusing the bankruptcy system.

Second, we are concerned that disaster relief payments may be counted as part of income for purposes of the means test and calculating repayment plans. These are limited payments, and should not result in a hurricane victim being treated as a high income debtor.

Third, we are concerned that BAPCPA may deny the court the discretion to extend certain deadlines for businesses devastated by Hurricane Katrina, inadvertently forcing businesses to liquidate – and lay off workers – as a result of an arbitrary deadline.

Other provisions of the new law that raise concerns about how it may be applied to victims of natural disasters include those that: require debtors who have suffered through natural disasters to complete the credit counseling and debtor education in order to get a discharge; make it easier for landlords to evict their tenants who are in bankruptcy; require onerous paperwork and documentation requests for materials that are lost or destroyed; may prevent debtors who

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[6] Peter G. Gosselin, New Bankruptcy Law Could Exact a Toll on Storm Victims, LA TIMES, Sept. 7, 2005.

[7] *Bankruptcy Relief and Natural Disaster Victims*, Congressional Research Service, September 14, 2005.

have been displaced due to a natural disaster from being able to file their cases in their new place of residence.

On October 5, 2005, the U.S. Trustees Office acknowledged that provisions of the new bankruptcy law are too harsh for the victims of Katrina and Rita. The General Counsel of the U.S. Trustee (UST) program issued formal guidance to field personnel in the affected regions to exercise restraint and discretion in the matters related to the means test, documentation, small business, and venue requirements[8]. These actions are a step in the right direction, but we are concerned that the UST is unable, by itself, to eliminate the threat posed by the new bankruptcy law when it comes to hurricane victims. In particular, there are many provisions of the new law that the UST is powerless to change, provisions that could cause debtors to lose their homes, their cars, or even the right to obtain a bankruptcy discharge. In some cases, the court also will have no discretion to keep a case open if debtors do not comply with document filing requirements. Congressional action is the only way to ensure that present and future hurricane victims get needed relief.

As a result of these concerns, we ask that you:

a. Identify any cases filed after October 17, 2005, where application of the means test – or the costs and difficulties of qualifying for a "special circumstances" exception – prevented a victim of a natural disaster from being eligible for chapter 7 relief.

b. Identify any cases filed after October 17, 2005, where disaster relief payments are counted as part of income for purposes of the means test or calculating repayment plans.

c. Identify any business cases filed after October 17, 2005, where a court did not have discretion to extend certain deadlines for businesses devastated by Hurricane Katrina or Rita. Identify any job losses associated with such cases.

d. Identify any cases filed after October 17, 2005, where a victim of a natural disaster (1) was not found to be exempt from the requirement of completing credit counseling and debtor education in order to get a discharge debtors,(2) was evicted from his or her residence after filing for bankruptcy as a result of the new law; (3) was not found exempt from the paperwork and documentation requirements of the new law, even though such paperwork or documentation may have been lost or destroyed in the

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[8] *Letter to Honorable F. James Sensenbrenner, Jr. from Assistant Attorney William E. Moschella,* October 5, 2005.

disaster; or (4) was not granted the opportunity to file their cases in their new place of residence.

2. Impact on Single Parents and Children

We are concerned that BAPCPA may have an adverse impact on single parents and their children, both as debtors and as creditors. On the debtor side, we are concerned that the means test, and additional paperwork burdens, will likely make more difficult for single parents to access the bankruptcy system. For example, the means test fails to omit support checks that have recently stopped as part of a custodial parent's average income, the paperwork requirements will likely increase fees for filing bankruptcy, and new nondischargeability categories threaten to limit custodial parents' ability to discharge basic credit card debts. Moreover, under the new law, if a parent filing for bankruptcy obtained cash advances to purchase basic necessities such as diapers or food, she could face litigation brought by a credit card company objecting to the discharge of the debt.[9]

On the creditor side, we are concerned BAPCPA will have an adverse impact on single parents and children by diminishing the likelihood of full payment of alimony and child support by debtors. Groups concerned with the payment of alimony and child support have argued that changes in the new law, such as the significant new categories of non-dischargeable debt, the extension of the length of chapter 13 plans, and the general limitations on the availability of chapter 7 relief, will create an environment where unsecured and credit card debt is far more likely to compete against alimony and child support obligations in the state law collection process. As Marshall Wolf has written on behalf of the Governing Counsel of the Family Law Section of the American Bar Association, "if credit card debt is added to the current list of items that are now not dischargeable after a bankruptcy of a support payer, the alimony and child support recipient will be forced to compete with the well organized, well financed, and obscenely profitable credit card companies to receive payments from the limited income of the poor guy who just went through a bankruptcy. It is not a fair fight and it is one that women and children who rely on support will lose."[10]

BAPCPA also provides a definition of "domestic support obligation" that includes funds owed to government units.[11] This means that if the government is collecting for its own benefit (say, for example, the woman recipient is on welfare and the government is collecting arrearages to reduce a state or Federal deficit), it will put the government collection agency in direct competition with single mothers and children, particularly in chapter 13.

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[9] BAPCPA, § 310.

[10] Statement of Marshall J. Wolf (May 13, 1998) (on file with the House Comm. on the Judiciary).

[11] Under current law, domestic support owed to families is a priority debt; support owed to the government is nondischargeable, but is not priority debt.

As a result of these concerns we ask that you:

a. Identify any change in the average amount of child support paid to custodial parents by debtors who filed in the twelve month period ending October 16, 2005 with amounts paid by debtors who filed during the twelve month period beginning October 17, 2005.

b. Identify any cases filed after October 17, 2005 in which a creditor was not discharged, but would have been discharged under the law prior to October 17, 2005, and as a result, was able to obtain payment at the expense of a custodial parent creditor.

c. Identify any cases filed after October 17, 2005, where governmental units are able to use their new bankruptcy authority to obtain payments at the possible expense of a custodial parent.

3. Impact on low and middle income debtors

Consumer groups and bankruptcy experts are concerned that the new law will unjustly affect low and middle income debtors who are unable to repay their debts under a chapter 7 plan. Instead of using the debtor's actual or projected income to calculate the debtor's ability to repay, the bill uses a fictitious "current monthly income," which, with certain exclusions, is the average of the debtor's income for the six months preceding the filing of the case. Even if, as is frequently the case, the debtor's bankruptcy was triggered by the loss of a job, or other precipitous loss in income due to serious illness or even mobilization for war, the means test would attribute to the debtor the lost income for the purposes of determining whether a debtor is abusing chapter 7. The means test will also pick up a variety of revenue sources – such as disaster assistance, and Veterans' benefits. Also, instead of using the debtor's actual expenses to determine the ability to repay non-priority unsecured debts, the bill relies on guidelines developed by the Internal Revenue Service to aid in the collection of tax debts.[12]

The means test is also used to calculate a debtor's income and expenses for the purposes of confirming a chapter 13 plan. Unlike the means test in chapter 7, however, there is no

[12]Rather than relying on the debtor's actual costs of living, the bill relies upon IRS collection standards, which lay out no comprehensive or specific standards for the deduction of living expenses. Part of the problem arises from the fact that the IRS standards referenced by the bill are not automatic in many cases. Although the IRS does set forth national standards for some expenses, such as food and clothing, and local standards for expenses such as housing and transportation, it leaves the determination of "other necessary expenses" to the discretion of the relevant IRS employee.

provision for a debtor to seek adjustments to current monthly income for "special circumstances," making the application of the means test in chapter 13 even more inflexible and unrealistic.

The new law also requires debtors to calculate the means test using expenses over 5 years rather than 3 years, and makes other changes to the way plans must be presented. These changes will make it more likely that debtors pushed into chapter 13 by the means test will not be able to complete a repayment plan -- the ostensible purpose of the means test in the first place. In view of the fact that approximately two thirds of all voluntary chapter 13 plans under current law are not completed, it is likely that even more debtors would be unable to confirm or complete the now-mandatory chapter 13. This legislation also greatly curtails the broader discharge currently available to debtors who have successfully completed a chapter 13 plan, eliminating a significant inducement for voluntary debtor participation in chapter 13. Making chapter 13 the only avenue for bankruptcy relief for some individuals and imposing the bill's strict income and expense tests may well result in an even smaller proportion of successful chapter 13 plans. Further, changes to chapter 13, such as the curtailment of stripdown for auto loans, will make it more difficult for even voluntary chapter 13 debtors to confirm or complete a plan.

Moreover, the increased costs involved with filing and new, burdensome paperwork requirements may make bankruptcy an unrealistic option for debtors already facing unmanageable debt and unforeseen life circumstances.

A joint study of bankruptcy filings by researchers at Harvard Medical School and Harvard Law School revealed that roughly half of all bankruptcies filed in 2001 were caused, at least in part by illness or medical debts[13]. Remarkably, 75 percent of bankruptcy filers with medical expenses had health insurance at the onset of their bankrupting illness.

In addition, due to the fact that BAPCPA, unlike current law, will permit creditors and other parties-in-interest to bring motions to dismiss or convert, more aggressive and well-funded creditors will have extremely wide latitude to use such motions as a tool for making bankruptcy an expensive, protracted, and contentious process for honest debtors, their families, and other creditors. Creditors could use such motions as leverage to obtain reaffirmation agreements so that their unsecured debts survive bankruptcy.

Finally, we are concerned that the new law permits landlords to continue eviction or unlawful detainer actions even after debtors have obtained an automatic stay by filing for bankruptcy. This could force many battered women, and families with children, and seniors out onto the streets, without ever having an opportunity to use the bankruptcy stay of other collection proceedings to catch up on their rent.

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[13] David U. Himmelstein et al., Marketwatch: Illness and Injury as Contributors to Bankruptcy, W5 HEALTH AFF. 63, 63 (2005) at www.healthaffairs.org.

As a result of these concerns we ask that you:

a. Identify any cases filed after October 17, 2005 where the debtor, who would have qualified to file chapter 7 before October 17, 2005, fails to confirm a plan under chapter 13.

b. Compare the rate at which plans failed under chapter 13, in the 12 month period ending on October 16, 2005, and the 12 month period beginning on October 17, 2005. Of these, identify the cases that converted to chapter 13 following a determination of "abuse" under the means test of the new Code.

c. Identify any cases filed after October 17, 2005, where the debtor was prevented from seeking chapter 7 relief because he or she was required to include income or other payments earned prior to the bankruptcy filing which will not be realized to all or the same extent after the filing.

d. Identify any cases filed after October 17, 2005, where IRS guidelines failed to adequately account for necessary expenses such as food, housing, health care, and education costs.

e. Identify the extent that for cases filed after October 17, 2005, circumstances beyond the debtor's control, such as illness, medical debts, loss of job, or divorce, led to the bankruptcy filing. For such cases, identify any where the debtor is prevented from obtaining chapter 7 relief as a result of the new law.

f. Identify any cases filed after October 17, 2005, where a creditor was able to use the possibility of filing a motion to dismiss or convert in order to obtain a reaffirmation agreement so that their unsecured debt survives bankruptcy.

g. Identify any cases filed after October 17, 2005, involving battered women and families with children or seniors who are evicted because of new provisions in BAPCPA permitting landlords to continue eviction or unlawful detainer actions after debtors have obtained an automatic stay.

4. <u>Impact on military families</u>

A 2004 GAO report cites that 16,000 active duty members of the military filed for bankruptcy relief over a 12 month period[14]. In addition, recent news stories have reported that National Guard and Reservists who are self employed are facing particularly difficult

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[14] U.S. GENERAL ACCOUNTING OFFICE, MILITARY PERSONNEL: BANKRUPTCY FILINGS AMONG ACTIVE DUTY SERVICE MEMBERS, GAO-04-465R (2004).

financial hardships that often force them to file for bankruptcy.[15] An estimated 10 percent of the over 125,000 Army National Guard soldiers deployed since September 11, 2001 are either self employed or work in small businesses[16] and some 40 percent of families of National Guard and Reservists reported lost income when a spouse was deployed.[17]

Service members often face their greatest financial hardships within the two years after their service is completed as they rebuild their families, their businesses, and their finances. During these 24 months they are most likely to file for bankruptcy. There is a concern that BAPCPA will serve to compound financial hardships and prevent families from obtaining needed debt relief by imposing an arbitrary means test that fails to distinguish debt incurred as a direct result of military service or to exempt new expenses related to physical or psychological injuries.

We are further concerned that BAPCPA fails to address the practice of abusive payday and other predatory lending practices targeted at military families. A 2003 National Consumer Law Center Report found that "scores of consumer-abusing businesses directly target this country's active duty military men and women daily." Unfortunately, Congress rejected amendments which would have prevented a creditor from recovering in bankruptcy amounts owed on a high-cost payday loan made to a service member or a dependent secured by a personal check for future deposit or electronic access to a bank account.

As a result of these concerns we ask that you:

a. Identify the number of national guard and reserve personnel who file for bankruptcy within 24 months of returning from service and describe and assess for us the leading causes of these bankruptcies.

b. Identify the number of service members who file for bankruptcy whose debt includes high cost predatory loans with interest rates above 30 percent per annum on compounded basis.

5. Credit Counseling

BAPCPA requires all debtors to undergo credit counseling before filing for bankruptcy and to complete a personal financial management course before receiving a discharge. The

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[15] Dave Moniz, *Guardsmen, Reservists Hit Hard at Home by Call-ups*, USA TODAY, Feb. 6, 2005.

[16] Brian MacQuarrie, *For Self Employed, Guard Duty Has a Price,* Boston Globe, Aug. 7, 2005.

[17] U.S. GENERAL ACCOUNTING OFFICE, MILITARY PERSONNEL: BANKRUPTCY FILINGS AMONG ACTIVE DUTY SERVICE MEMBERS, GAO-04-465R (2004).

Executive Office of the United States Trustee (EOUST) was charged with approving organizations to provide these services. Although many experts agree that credit counseling can help some indebted consumers, if properly administered at the right time by a legitimate nonprofit agency offering a range of services, credit counseling agencies have been under scrutiny for several years for a variety of unfair and deceptive practices.

In March of this year, the Federal Trade Commission announced settlements with three debt services operations (including one credit counseling organization) that had defrauded consumers out of more than one hundred million dollars[18]. The Senate Permanent Subcommittee on Investigations recently issued the final results of its investigation of profiteering and abusive acts in the industry and called for state and federal regulators to take a number of steps to prevent these problems in the future[19]. The IRS says that it is auditing 50 of the largest nonprofit agencies in the country and on October 12, 2005, announced that it would be revoking the non-profit status of 20 of the largest agencies in the country[20].

Additionally, several specific concerns have arisen as the Executive Office of the United States Trustee (EOUST) has prepared to implement the law. For example, in an effort to ensure that unscrupulous agencies do not offer counseling, EOUST has approved fewer than 50 agencies to offer the pre-filing requirement to debtors throughout the country. This has raised serious concerns about whether adequate capacity will exist to offer the pre-filing requirement on a timely basis to everyone who is mandated to receive it. It has also raised concerns about whether debtors who choose to receive counseling in-person will be able to receive it. (Large parts of the country will only be served by agencies that offer telephone counseling.) Questions have also arisen about whether ongoing or increased funding by credit card issuers of credit counseling will lead to counseling that is not accurate or objective or the inappropriate enrollment of debtors in Debt Management Plans[21].

As a result of these concerns, we ask that you assess the following issues:

a. Are any of the agencies that have been approved to offer either of the credit counseling requirements mandated by law among those that the IRS has determined should have their nonprofit status revoked? Have any of the agencies that have been approved to offer either of the credit counseling requirements

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[18] "Debt Settlement Services Operations Settle FTC Charges," Federal Trade Commission News Release, March 30, 2005.

[19] "Profiteering in a Non-Profit Industry: Abusive Practices in Credit Counseling, Permanent Senate Subcommittee on Investigations. April 13, 2005.

[20] "Credit Counselors' Tax Status in Jeopardy," Washington Post, October 13, 2005

[21] "Creditors' Role in Counseling Draws Critics," New York Times, October 14, 2005

mandated by law been sanctioned or placed under investigation by a federal or state regulatory body or enforcement authority for unfair, deceptive or misleading practices?

b. What fees are agencies charging for both the pre-filing briefing and the pre-discharge instructional course? Are agencies meeting the statutory mandate to assist consumers without regard to ability to pay and to charge reasonable fees?

c. Are credit counseling agencies providing advice or information to consumers regarding whether or not they should consider bankruptcy, or about the potential advantages and disadvantages of declaring personal bankruptcy? Does the fact that the credit industry is funding these operations create a bias in the type of information these credit counseling agencies are providing to debtors?

d. Does adequate capacity exist for debtors to receive either in person or telephone counseling, whichever they choose, within five days?

e. Identify any cases involving the use of the law's "exigent" circumstances exception for debtors who are unable to obtain counseling within five days?

f. Identify an cases filed after October 17, 2005 where a debtor was unable to obtain bankruptcy relief because of the costs of credit counseling or the lack of availability of credit counseling services.

6. <u>Impact on Business Bankruptcies and Employees</u>

The business provisions of BAPCPA will effectuate a number of changes in the manner in which corporations, partnerships, and other business entities are permitted to reorganize their financial affairs. With respect to small business, BAPCPA would expand the definition of covered small business to those companies having debts of not more than $2 million,[22] subsuming more than 80% of all chapter 11 cases.[23] It will also make the small business requirements mandatory (rather than optional) and mandate the operation of numerous additional requirements on debtors.[24] For example, under the new law, small business debtors would be required to provide balance sheets, statements of operations, cash-flow statements, and income-tax returns within three days after filing a bankruptcy petition, the time period the debtor has the

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[22] S. 256, § 432 (proposed amendment to 11 U.S.C. § 101(51D)).

[23] *Hearing on Consumer Bankruptcy Issues in H.R. 3150, the "Bankruptcy Reform Act of 1999," Before the House Subcomm. on Commercial and Admin. Law*, 105th Cong. 255 (Mar. 18, 1999)(written statement of Jere W. Glover, Chief Counsel for Advocacy, SBA).

[24] S. 256, § 436 (proposed 11 U.S.C. § 1116).

exclusive right to file a plan of reorganization would be modified, and the standards for seeking an extension of this time period will be substantially narrowed.[25] The new law also expands the grounds on which the court can dismiss or convert a small business case. For example, a case will be presumptively dismissed when the debtor fails to comply with a lengthy list of requirements. It is for these reasons that the AFL-CIO, warned that the small business provisions in the bill will "threaten jobs by placing substantial procedural and substantive barriers in the way of small businesses' access to the protections of Chapter 11 . . . . threaten jobs by requiring commercial debtors to assume or reject commercial leases within a rigid timetable, which would force debtors to favor one class of creditors over others, and threaten their overall ability to successfully reorganize."[26]

A similar concern relates to single-asset real estate (SARE) debtors. BAPCPA significantly expands the definition of SARE by eliminating the $4 million debt cap pursuant to a "technical correction" in section 1201(5) of Title XIII, and would take in SARE bankruptcies below that cap and treat them as small businesses. As a result of these changes, a much wider range of real estate operations would be required to conform with the SARE and small business requirements when they seek to reorganize, notwithstanding the fact that those requirements were drafted with a much smaller and simpler entity in mind. Large operating entities such as Rockefeller Center, as well as hotels and nursing homes, could be considered SARE and put back on the track set forth in section 362(d)(3) of the Bankruptcy Code. It would also create new incentives for lenders to require that all of their real estate borrowers place their holdings in the single asset form in order to avoid ordinary bankruptcy rules in the future. During consideration of the new law in Congress, the AFL-CIO noted,

"the significant limiting factor in the application of these rules has been the $4 million cap. [Eliminating] the cap would place a wide variety of properties . . . at risk of foreclosure and threaten jobs at these properties. Absent rules that specifically exclude properties such as housing and those with significant business enterprises, there should be no expansion in the definition of single-asset real estate debtor."[27]

Additional concerns have been raised regarding inflexible new mandates and deadlines imposed on businesses generally in chapter 11. For example, the law will place an absolute time limit on the time period a business debtor has the exclusive right to file a plan of reorganization.[28]

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[25] S. 256, § 437 (proposed amendment to 11 U.S.C. § 1121(e)).

[26] Letter from Peggy Taylor, Director of Legislation, AFL-CIO, to the Honorable Henry J. Hyde, Chair, House Comm. on the Judiciary (Apr. 20, 1999).

[27] *Id.* at 237 (written statement of Damon A. Silvers, Associate General Counsel, AFL-CIO).

[28] S. 256, § 411.

Many believe this change alone, led to such large companies as Delta, Northwest Airlines, and most recently, Delphi to seek bankruptcy relief before this change took effect.

While many of the largest corporate bankruptcy cases in American history, such as Enron, Worldcom, Adelphia, and Polaroid have occurred in the eight years since the bankruptcy bill first was written, proponents of the new legislation have refused to address the use of corporate bankruptcy as a toll to avoid obligations to employees. The new bankruptcy law contains no meaningful response to this apparent rise in corporate bankruptcy. The current bankruptcy laws, as amended by BAPCPA, remain inadequate to address the resulting consequences for workers and retirees who have their pension plans and health benefits cancelled during the course of a corporate restructuring resulting from corporate abuse. In particular, the United Steelworkers of America have observed that the new law does nothing to stem the rapid loss of pension benefits for members and retirees:

> In the steel industry alone, 45 steel companies have filed for bankruptcy since 1997. This has left over 250,000 USWA members and retirees with greatly reduced pensions and the burden of paying out-of-pocket medical expenses, which the Center for American Progress (CAP) has found to be one of the key factors that consistently leads to personal bankruptcy. We strongly feel that this legislation needs to address the effects corporate bankruptcies have on workers and retirees.[29]

Groups such as the AFL-CIO and the National Bankruptcy Conference have highlighted further concerns about the business provisions, pointing to the expansion of remedies available to secured creditors in the transportation industry;[30] limits on subsequent filings for troubled small businesses,[31] and provisions giving utility companies an enhanced position in bankruptcy.[32] Similar concerns relate to the power of creditors who lease retail property. The legislation grants lessors of commercial property the ability to coerce debtor-tenants into deciding prematurely whether to assume or reject a lease.

As a result of these concerns, we ask that you:

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[29] Letter from William J. Kleinfelter, Assistant to the President, United Steelworkers of America to Members of the U.S. Senate (Feb. 28, 2005).

[30] *Hearing on Consumer Bankruptcy Issues in H.R. 3150, the "Bankruptcy Reform Act of 1999," Before the House Subcomm. on Commercial and Admin. Law*, 105th Cong. 235 (Mar. 18, 1999). *March 18, 1999 House Judiciary Committee Hearing* (written statement of Damon A. Silvers, AFL-CIO); March 17, 1999 Hearing (written statement of Kenneth Klee, National Bankruptcy Conference).

[31] S. 256, § 441.

[32] S. 256, § 417.

a. Identify the portion of chapter 11 cases filed after October 17, 2005, that fall within the definition of "small business cases," compared with the portion of cases filed in the previous year. To the extent cases fall within the new definition, identify any job losses resulting from the businesses liquidation or other failure to complete a plan of reorganization.

b. Identify the portion of real estate chapter 11 cases filed after October 17, 2005, that fall within the definition of SARE, compared with the portion filed in the previous year. To the extent cases fall within the new definition, identify any job losses resulting from the businesses liquidation or failure to complete a plan of reorganization.

c. Identify any chapter 11 cases filed after October 17, 2005, where the new limitations on exclusivity or other business deadlines and mandates have an adverse impact on the businesses ability to complete a plan of reorganization. Identify any job losses associated with such cases.

d. Identify how often business cases filed after October 17, 2005 that employees, retirees, and their families lose or forfeit pension or health care benefits in bankruptcy.

7. <u>New costs to the bankruptcy system</u>

We are concerned that BAPCPA will impose substantial new costs on the bankruptcy system - both the portions paid for by private parties and those borne by the federal government. Specifically, substantial new costs will be incurred by consumers and others in the payment for private chapter 7 and chapter 13 trustees and higher attorney fees, as well as through the bankruptcy courts and the U.S. Trustees Program.

The Congressional Budget Office has estimated that BAPCPA will cost the federal government $392 million over the next five years, with an added cost of $26 million for additional judges to administer new rules. Part of this cost estimate derives from implementing the complex and paper work heavy means testing program. Additional sources of higher costs for the government will likely derive from the requirements for random audits in each federal district and the new requirements imposed on U.S. trustees to certify availability of credit counseling and visit sites in chapter 11 cases.

In comments submitted when the new law was under consideration in Congress[33], the American Bar Association noted that the costs on the new law to the private sector will be

[33] Letter from Robert D. Evans, Director of Governmental Affairs, American Bar Association, to Hon. Arlen Specter, Chairman, Senate Committee on the Judiciary (Feb. 8, 2005)

substantial and will have a negative impact on the availability of quality legal counsel in bankruptcy. In particular, the ABA expressed its concern regarding provisions in the bill that require an attorney to: (1) certify the accuracy of factual allegations in the debtors bankruptcy petition and schedules, under penalty of harsh court sanctions; (2) certify the ability of the debtor to make payments under a reaffirmation agreement; and (3) identify themselves as "debt relief agencies" subject to a host of new intrusive regulations. The ABA concludes that these new mandates will have a substantial negative impact on the availability of quality legal counsel in bankruptcy.

As a result of these concerns we ask that you:

a. Identify the actual increased costs to the federal government, including the cost of (1) new judges and increased workload, (2) implementation of the means testing program, performing random audits, certifying credit counseling, and visiting sites in chapter 11 cases, and (3) creating and processing increased paperwork.

b. Identify the increased costs to private trustees in administering chapter 7 and chapter 13 cases such as the cost of reviewing income and expenses, filing certifications, and motions. Is there an identifiable decrease in practicing private trustees during the 12 month period beginning October 17, 2005?

c. Identify any increase in cost for debtors obtaining bankruptcy relief in the 12 months following October 17, 2005 compared to the 12 months before October 16, 2005, including increases in attorneys fees, the cost of credit counseling, and cost of assembling new documentation required by the law. Estimate the number of debtors who were unable to file bankruptcy cases, or to be represented by an attorney in bankruptcy cases, due to these increased costs.

8. <u>Impact on Homestead Exemption and Asset Trust Loopholes</u>

BAPCPA failed to put an end to two of the most notorious abuses of the bankruptcy system--the financial planning strategy by which debtors are able to purchase expensive homes in states which allow a debtor to exempt an interest in a primary residence of a unlimited dollar value, and the development of "asset protection trusts," which would allow individuals to set up a trust for which they are the sole beneficiaries, and potentially place substantial assets outside the estate, and beyond the reach of the creditors.

While BAPCPA restricted the amount an individual debtor may claim under certain circumstances, and modified the domiciliary requirements for claiming a state's exemptions, it retained the unlimited homestead exemption, known as the "millionaires' loophole," that has allowed the very wealthy to shield from their creditors vast sums of money in palatial homes. A proposal to place an absolute cap on state homestead exemptions in the amount of $1 million was rejected by House conferees to predecessor legislation in the 107th Congress. Thus, while the new law presumes that debtors of modest means are abusing the system if they can pay general unsecured creditors as little as $100 a month in chapter 13, it continues to permit the most notorious abuse of the consumer bankruptcy system.

Another loophole retained by the legislation is the so-called "asset protection trust," which, under the law of various states, allows an individual to set up a trust account for which the person establishing the trust would also be the beneficiary.[34] Trusts, established under non-bankruptcy law, are not treated a property of the bankruptcy estate, and so are beyond the reach of creditors.[35] A debtor may, under the laws of these states, establish such a trust, solely for the benefit of the debtor, and may be able to shield unlimited amounts of money from creditors. So long as the funds were not placed in the trust by means of a fraudulent transfer, the trustee might have no power to recover them for the benefit of the creditors.

As a result of these concerns, we ask that you:

a. Identify cases filed after October 17, 2005, where debtors were able to claim an unlimited homestead exemption under state law, notwithstanding changes made to the Code by BAPCPA? Identify how many debtors who filed for bankruptcy within 12 months following October 17, 2005 claimed a homestead over $300,000, over $500,000, and over $1 million.

b. Identify cases filed after October 17, 2005, where asset trusts enabled debtors to shield property from bankruptcy.

9. <u>Impact on credit industry practices</u>

Proponents of BAPCPA have long contended that enactment of the legislation will result in economic benefits for all Americans. A witness at a Senate Judiciary Committee hearing argued that "every phone bill, electric bill, mortgage, furniture purchase, medical bill, and car loan contains an implicit bankruptcy `tax' that the rest of us pay to subsidize those who do not pay their bills." He concluded that, "We all pay for bankruptcy abuse in higher down payments, higher interest rates, and higher costs for goods and services". One firm estimated that the cost of consumer bankruptcies cost the average American some $400 annually, and estimated enactment of the bill's means based income test alone, would decrease the costs of bankruptcy by from 8-17% annually.[36]

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[34] Gretchen Morgenson, *Proposed Law on Bankruptcy Has Loophole*, N. Y. TIMES, Mar. 2, 2005, at C1.

[35] 11 U.S.C. 541(c)(2) (2004).

[36] Wharton Econometric Forecasting Associates ("WEFA") examined the financial cost of personal bankruptcy cases filed in 1997, which it defined as "the amount of credit dollars (outstanding loans) lost due to bankruptcy filings . . . [and] the costs of the U.S. court system . . . and other creditor's expenses relating to

Consumer advocates, however, remain concerned that not only are these statements ill founded, but more importantly BAPCPA fails to address seriously the problem of abusive lending practices that often push consumers into difficult economic situations. The bill also ignores the problem of credit card companies lending to minors as well as individuals with already substantial debts and little prospect of repayment. One credit card company goes so far as to solicit debt counselors and offers them $10 for each chapter 7 client who requests a credit card.[37] A particularly pernicious credit card practice occurs in the so-called "subprime" market, where lenders seek out riskier borrowers and offer home equity financing at loan to value ratios in excess of 100%. Another lending abuse targets low-income and minority neighborhoods with "serial" refinancing loans that carry high-interest rates and other onerous terms.[38] In essence this causes poor individuals to place their homes at risk in order to finance their credit card purchases.

Evidence suggests that it is the massive increase in consumer debt, not any change in bankruptcy laws, that has brought about the increases in consumer filings. Indeed, there is an almost perfect correlation between the increasing amount of consumer debt and the number of consumer bankruptcy filings. For example, credit card debt more than tripled between 1989 and 2001 from $238 billion to $692 billion, and personal bankruptcy filings increased accordingly.[39]

As a result of these concerns we ask that you:

a. Identify the profits of the top five credit card issuers during the twelve months ending of October 16, 2005 and the twelve months following October 17, 2005

b. Adjusting for increase in prime, identify the average credit card interest rates on April 20, 2005, October 17, 2005 and April 20, 2006. Similarly, identify any change in retail prices for goods and services on these dates.

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bankruptcy." WEFA Group Resource Planning Service, *The Financial Costs of Personal Bankruptcy* 4 (Feb. 1998).

[37] Letter from American Bankruptcy Service, to Michael Schwartz (Dec. 18, 1998).

[38] *Hearing on Consumer Bankruptcy Issues in H.R. 3150, the "Bankruptcy Reform Act of 1999," Before the House Subcomm. on Commercial and Admin. Law*, 105th Cong. 240 (Mar. 18, 1999) March 18, 1999 Hearing (written statement of Damon A. Silvers, AFL-CIO, n.9) ([citing Debra Nussbaum, "*Lenders Laud the Value of Home Sweet Equity*," N.Y. TIMES, Mar. 22, 1998, § 3 at 10; Richard W. Stevenson, "*How Serial Refinancings Can Rob Equity*," N.Y. TIMES, Mar. 22, 1998, § 3 at 10). *See also* Julia Patterson Forrester, "*Mortgaging the American Dream: A critical Evaluation of the Federal Government's Promotion of Home Equity Financing*," 69 TUL.LANE L. REV. 373 (1994).

[39] *See* TAMARA DRAUT & JAVIER SILVA, DEMOS: A NETWORK FOR IDEAS AND ACTION, BORROWING TO MAKE ENDS MEET: THE GROWTH OF CREDIT CARD DEBT IN THE 90S 9 (2003) *available at* www.demos-usa.org

c. Determine the extent to which the average cost of consumer credit or retail prices for goods and services decrease within the six months following October 17, 2005 as a result of creditors passing on any "savings" from enactment of BAPCPA.

d. Identify any cases filed after October 17, 2005 involving significant credit card debt issued to minors.

e. Identify any cases filed after October 17, 2005 involving "subprime" loans, where lenders seek out riskier borrowers and offer home equity financing at loan to value ratios in excess of 100%.

10. Tax Provisions

In the past, the Bankruptcy Code sought to effectuate a delicate balance between the rights of the Internal Revenue Service and state tax agencies to the repayment of any taxes, interest, and penalties owed them, and the rights of other creditors and the ability of individuals and corporations to be financially rehabilitated for the benefit of all parties. However, Title VII of BAPCPA manifests a strong preference for the IRS and other taxing authorities to the detriment of other participants in the bankruptcy system. Concerns have been expressed that, not only does BAPCPA generally enhance the rights and position of the IRS and state authorities in bankruptcy, it also grants the IRS certain rights in bankruptcy cases that it does not enjoy outside of bankruptcy, and vests the IRS with new enforcement powers that ordinary creditors do not possess.[40] Of particular concern is the fact that BAPCPA varies in many significant respects from the nonpartisan, and often unanimous, recommendations of the Bankruptcy Commission and its Tax Advisory Committee.

As a result of these concerns, we ask that you :

a. Assess for cases filed after October 17, 2005, the extent to which the new tax provisions have made it more difficult for individual debtors to obtain a fresh start and complete a chapter 7 or 13 case.

b. Assess for cases filed after October 17, 2005 the extent to which the new tax provisions made it more difficult for businesses to reorganize under the bankruptcy laws.

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[40] *Hearing on Consumer Bankruptcy Issues in H.R. 3150, the "Bankruptcy Reform Act of 1999," Before the House Subcomm. on Commercial and Admin. Law*, 105th Cong. 337 (Mar. 18, 1999). (written statement of Paul Asofsky, Chair, Task Force on the Tax Recommendations of the National Bankruptcy Review Commission of the American Bar Association's Tax Section).

The results of your investigation will be very important to us and are time sensitive. Please have your office respond to Rep. Conyers' Judiciary Committee office at 225-6504, 2142 Rayburn House Office Building, Washington, DC 20515.

Thank you for your prompt consideration of this matter.

Sincerely,

John Conyers Jr.
Melvin L. Watt
Jerrold Nadler
Zoe Lofgren
Bobby Scott
Howard L. Berman
William D. Delahunt

Russell D. Feingold
Patrick Leahy
Dick Durbin
Ted Kennedy
Chris Van Hollen
Debbie Wasserman Schultz M.C.
Sheila Jackson Lee